Supreme Court, U.S.
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No. _____

In the
Supreme Court of the United States

NEDZAK KRZALIC AND DANIJELA KRZALIC,
Petitioners,

v.

REPUBLIC TITLE CO.,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

The Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. §2607 *et seq.*, was enacted to ensure that consumers be "protected from unnecessarily high settlement charges caused by certain abusive practices that have developed . . . ." 12 U.S.C. § 2601. In the fall of 2001, HUD issued its Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b). The questions presented are:

1. Whether the Seventh Circuit improperly refused to follow *Chevron, USA, Inc. v. Natural Res. Defense Council, Inc.*, 467 U.S. 837, 842 (1984), instead creating a new category of deference called "sub-Chevron deference."

2. Whether the Seventh Circuit erred by holding that the Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b), 66 FR 53052-01 (hereinafter "2001-1 Policy Statement") is not entitled to deference under *Chevron, USA, Inc. v. Natural Res. Defense Council, Inc.*, 467 U.S. 837, 842 (1984).

3. Whether the Seventh Circuit erred by holding that a lender who overcharges consumers for settlement services, specifically the recording of documents, does not commit a violation of 12 U.S.C. § 2607(b).

PARTIES TO THE PROCEEDINGS

This petition involves an appeal from the United States Court of Appeals for the Seventh Circuit. The following is a list of all parties to the proceeding whose judgment is sought to be reviewed:

Nedzad Krzalic, Plaintiff-Petitioner
Danijela Krzalic, Plaintiff-Petitioner

Republic Title Company, Defendant-Respondent

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Petitioners, Nedzad Krzalic and Danijela Krzalic, respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit.

OPINIONS BELOW

The citations of the official and unofficial reports of the opinions and orders entered in this cases are as follows:

The Opinion of the United States Court of Appeals for the Seventh Circuit is reprinted as Appendix A. The official citation for this opinion is *Krzalic v. Republic Title Co,* 314 F.3d 875 (7th Cir. 2002).

The Opinion of the United States District Court for the Northern District of Illinois is reprinted as Appendix B. It is reported as *Krzalic v. Republic Title Co,* 2002 WL 1008465 (N.D. Ill. 2002).

JURISDICTION

This petition involves a decision of the United States Court of Appeals for the Seventh Circuit. The Seventh Circuit entered final judgment on December 26, 2002. This petition was filed within 90 days of that date. This Court has jurisdiction to review this case pursuant to 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

The following statutes are set forth in Appendix C to this Petition: 12 U.S.C. § 2607(b) and HUD Regulation X, 24 C.F.R. § 3500.14.

STATEMENT OF THE CASE

The Krzalics filed a lawsuit against Republic Title Company in the Northern District of Illinois. They alleged that Republic Title Company collected excessive fees for government recording and transfer charges in violation of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2607(b) and implementing HUD Regulation X, 24 C.F.R. § 3500.14. The district court had jurisdiction under 12 U.S.C. §2614 (Real Estate Settlement Procedures Act), and 28 U.S.C. §§ 1331 (general federal question), 1337 (interstate commerce) and 1367 (supplemental jurisdiction).

A. Factual Background

Respondent Republic Title Company ("Republic") is engaged in providing closing and settlement services. It acted as the closing agent for the Krzalics' purchase of residential real estate which occurred on September 17, 2001. In connection with these types of transactions, Republic often undertakes to record certain documents. With regard to the Krzalic transaction, Republic undertook to record a mortgage and a release.

Petitioners, Nedzad Krzalic and Danijela Krzalic paid Republic what it represented to be a $49.50 recording fee for the mortgage and a $25.50 recording fee for the release. These charges, in addition to all other costs related to the transaction, are set forth on the Settlement Statement,

prepared on the form issued by the United States Department of Housing and Urban Development pursuant to 12 U.S.C. §2603, and are represented as "government recording and transfer charges". These amounts were paid by the plaintiffs to Republic as closing agent, who was then to pay them to the Recorder of Deeds. However, the Recorder of Deeds actually charged only $35.50 for the mortgage and $23.50 for the release, as shown by the stamps on the mortgage and release.

The additional $16 kept by defendant was unearned and did not constitute payment for goods or services actually furnished or performed. Petitioners further alleged that Republic Title violated 12 U.S.C. § 2607(b) and implementing HUD Regulation X, 24 C.F.R. § 3500.14, by causing plaintiffs to give an inflated amount (to be paid to the Recorder of Deeds) for governmental fees, and then splitting the "governmental fees" between the Recorder of Deeds and itself. Petitioners also alleged that this violates state law.

B. Proceedings Below

Republic moved to dismiss the RESPA claims under Fed.R.Civ.P. 12(b)(1) and 12(b)(6) arguing that respondent had not committed a violation of RESPA because there was no agreement with a third party to "split" the overcharge. The district court agreed and petitioners appealed to the United States Court of Appeals for the Seventh Circuit. The Department of Justice filed a brief as *Amicus Curiae* for the United States supporting reversal.

The Seventh Circuit concluded that § 8(b) is solely an anti-kickback provision and that, just as in the case of *Echevarria v. Chicago Title & Trust Company* 256 F. 3d 623 (7th Cir. 2001), there was no kickback. The court concluded

that the excessive fees collected by the Respondent did not amount to a violation of RESPA or Regulation X.

The Department of Housing and Urban Development is authorized to "prescribe such regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of' the Act," 12 U.S.C. §2617(a) The Seventh Circuit acknowledged that in response to its decision in the *Echevarria* case, HUD issued a Policy Statement. On its face, the Policy Statement makes clear that the practice complained of is a violation which the statute sought to deter. The Seventh Circuit acknowledges that HUD has "stated its disagreement with our decision and made clear its view that Section 8(b) is not 'limited to situations where at least two persons split or share an unearned fee.'"

However, the Seventh Circuit concluded that "[t]here is not enough play in the statutory joints to allow HUD to impose its own 'interpretation' under the aegis of *Chevron*...If an agency is to assume the judicial prerogative of statutory interpretation that Chevron bestowed upon it, it must use, not necessarily formal adjudicative procedures or its closest nonadjudicative counterpart, which is notice and comment rulemaking...but, still, something more formal, more deliberate, than a simple announcement." As far as the Seventh Circuit is concerned, a "simple announcement" is too far removed from the process by which courts interpret statutes to earn deference. Therefore, the Seventh Circuit refused to apply this Court's ruling in *Chevron, USA, Inc. v. Natural Res. Defense Council, Inc.*, 467 U.S. 837, 842 (1984).

Regardless of the view promulgated by HUD in its Policy Statement, the Seventh Circuit went on to hold that

because Respondent "received no part of a fee charged by someone else," there was no violation. On its face, the Policy Statement makes clear that the practice complained of is a violation which the statute sought to deter. Nonetheless, the *Krzalic* court opined that the discussion in the Policy Statement of the unearned fees issue is "perfunctory" and that no reason exists for a result alternative to that reached in *Echevarria*. Thus, it affirmed the dismissal of Petitioners' RESPA claims.

REASONS FOR GRANTING THE PETITION

I.

THIS CASE PRESENTS AN IMPORTANT BUT UNRESOLVED QUESTION OF LAW.

Supreme Court Rule 10(c) provides that a factor favoring certiorari is that "a United States court of appeals has decided an important question of federal law that has not been, but should be, settled by this Court, or has decided an important federal question in a way that conflicts with relevant decisions of this Court."

The decision below involves questions of exceptional importance in that the Seventh Circuit has issued an opinion that is contrary to RESPA and the Policy Statement issued by the Department of Housing and Urban Development and frustrates its goal of protecting home buyers from abusive practices by mortgage brokers and lenders in charging unnecessarily high settlement charges. Furthermore, the Seventh Circuit's refusal to give deference to the Policy Statement is contrary to *Chevron* and decisions of the Eighth, Ninth and Eleventh Circuits, all of which held that the Policy Statement is entitled to *Chevron* deference. *Glover v.*

Standard Federal Bank, 283 F.3d 953 (8th Cir. 2002); *Schuetz v. Banc One Mortgage Corp.*, 292 F.3d 1004 (9th Cir. 2002); *Heimmermann v. First Union Mortgage Corp.*, 305 F.3d 1257 (11th Cir. 2002).

A. The Importance Of The Real Estate Settlement Procedures Act.

In order to protect home buyers, in 1974 Congress enacted the Real Estate Settlement Procedures Act ("RESPA"). It represents a response by Congress to perceived abuses in the real estate settlement process and an attempt to protect consumers from unnecessarily high settlement charges resulting from those abuses.

The stated purposes of RESPA were to bring about certain changes in the settlement process for residential real estate that would result in (1) more effective advance disclosure of settlement costs to home buyers and sellers; (2) elimination of kickbacks or referral that had the tendency to increase unnecessarily the costs of certain settlement services.12 U.S.C.A. §2601. In particular, §2607 prohibits improper kickbacks and unearned fees in connection with loans and settlement services.

Regulation X, found at 24 C.F.R. §§3500 et. seq., was promulgated by the Secretary of Housing and Urban Development pursuant to the Act. Section 3500.14 reiterates the statutory prohibitions and exemptions contained in §8(a)-(c).

12 U.S.C.A. §2607, together with Regulation X is intended to protect home buyers from abusive practices by mortgage brokers and lenders in charging unnecessarily high settlement charges. RESPA § 8(b) states:

> **No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.**

12 U.S.C. § 2607(b). Further, Implementing HUD Regulation X, 24 CFR part 3500.14(c), provides:

> (c) ***No split of charges except for actual services performed.*** **No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a settlement service in connection with a transaction involving a federally-related mortgage loan other than for services actually performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section. The source of the payment does not determine whether or not a service is compensable. Nor may the prohibitions of this Part be avoided by creating an arrangement wherein the purchaser of services splits the fee. (Emphasis added).**

In a statement concerning guidance on completing settlement statements related to home mortgage loans, the

FDIC and HUD jointly issued a policy statement which explicitly states that charges such as those at issue here are violative of RESPA:

> **Question 1.** Whether a lender may "markup" a third party vendor's fees for the purpose of making a profit when no additional services are provided by the lender and thereby disclose the "marked-up" fee on the HUD-1, or whether the lender is limited to charging/disclosing its actual cost in obtaining the service?
>
> **RESPONSE:**
> A lender that purchases third party vendor services for purposes of closing a federally related mortgage loan may not, under RESPA, mark up the third party vendor fees for purposes of making a profit. HUD has consistently advised that where lenders or others charge consumers marked-up prices for services performed by third party providers without performing any additional services, such charges constitute "splits of fees" or "unearned fees" in violation of Section 8(b) of RESPA.
>
> Section 8(b) of RESPA provides that "no person shall give and no person shall accept any portion . . . of any charge made or received for the rendering of a real estate settlement service . . . other than for services actually performed." *12 USC 2607*(b). The RESPA regulations repeat this prohibition under 24 CFR 3500.14(c), adding that "[a]

charge by a person for which no or nominal services are performed . . . is an unearned fee and violates this section." Under these provisions, any settlement service provider that charges a fee as a "mark-up" of a fee for a third party's services in a covered transaction without itself rendering services or furnishing goods in exchange for that portion of the fee would violate RESPA's prohibitions against split or unearned fees.

This has been a long-standing position of HUD, and was most recently articulated in a preamble of a final rule issued with a statement of policy on computerized loan origination systems, on June 7, 1996 *(61 Fed. Reg. 29238)*. n1 That publication states, in part:

HUD believes that Section 8(b) of the statute and the legislative history make it clear that no person is allowed to receive "any portion" of charges for settlement services, except for services actually performed. This provision of Section 8(b) could apply in a number of situations: (1) where one settlement service provider receives an unearned fee from another provider; (2) where one settlement service provider charges the consumer for third party services and retains an unearned fee from the payment received; or (3) where one settlement service provider accepts a portion of a charge (including 100% of the charge) for other than services actually performed. *(61 FR 29238, 29249)*. n1

The final rule was subsequently blocked by Congress (*12 U.S.C. 2617*(d)), and did not become effective (see *61 FR 51782*, October 4, 1996). However, the quoted language was a restatement of long-standing HUD policy on Section 8(b), which remained unaffected by the disposition of the final rule. The statement of policy on computerized loan origination systems (Statement of Policy 1996-1) published with the final rule on June 7, 1996 *(61 FR 29255)*, remains in effect.

The HUD-1 and HUD-1A Settlement Statement must reflect the amount actually paid to the third party settlement service provider- that is, the actual amount of the fee-in compensation for the third party services. This is set forth in the General Instructions to the HUD-1, made applicable in 24 CFR 3500.8(b) and found in Appendix A to part 3500, which state that the settlement statement shall "itemize all charges imposed upon the Borrower and the Seller by the Lender . . . and any other charges which either the Borrower or the Seller will pay for at settlement . . . The names of the recipients of the settlement charges in section L . . . should be included in the blank lines." (Emphasis added.) The instructions for Section L pertaining to settlement charges further clarify that "for all items except for those paid to and retained by the Lender, the name of the person or firm ultimately receiving the payment should be shown." Pursuant to these

> provisions, charges for third party services must be separated and specifically itemized.
>
> If the lender charges additional amounts for performing actual services in connection with a particular settlement service purchased from a third party (for example, processing and evaluating an applicant's credit report purchased from a third party credit reporting company), those amounts cannot simply be added to the fee paid to the third party provider for disclosure purposes. Rather, such charges by lenders for processing or other services must be broken out from the particular third party fee and specifically identified and disclosed in the line item reserved for processing or origination costs (line 801) or, in accordance with section 3500.9(a)(4), may be inserted in blank spaces.

2000 FDIC Inter. Ltr. LEXIS 39, *24-27.

As explained in the 2000 FDIC - HUD policy statement, there are specific instructions regarding how the Settlement Statement is to be filled out. The instructions require that the settlement statement shall "itemize all charges imposed upon the Borrower and the Seller by the Lender . . . and any other charges which either the Borrower or the Seller will pay for at settlement" and "[f]or all items except for those paid to and retained by the Lender, the name of the person or firm ultimately receiving the payment should be shown." 24 C.F.R. 3500, App. A. In other words, Republic must separately state its fee and third party fees.

As can be seen, consistent with the purposes underlying RESPA, HUD has long interpreted RESPA's §8(b) as a prohibition of all unearned fees. In fact, HUD has specifically advised, as far back as 1976, that as well as taking or receiving a kickback, it "is also illegal to charge or accept a fee or part of a fee where no service has actually been performed." 41 Fed.Reg. 20, 280,20,289 (1976).

The Seventh Circuit, in the *Echevarria* case, said that this was not good enough. Therefore, HUD issued the 2001 Policy Statement.

b. The Importance Of The *Krzalic* Decision.

The *Krzalic* decision eviscerates both RESPA and this Court's ruling in the *Chevron* case. It invites blatant evasion of the prohibitions against unearned fees. If it is allowed to stand, it will frustrate RESPA's goal of protecting consumers from unnecessarily high settlement charges by holding that lenders and settlement service providers are not subject to liability for violation of the unearned fees provision provided that they overcharge a borrower and keep the entire "profit" for themselves.

The practical effect of *Krzalic* is a license to take advantage of borrowers. The negative impact that such a ruling will have on consumers cannot be ignored. HUD has always maintained the position that under RESPA, it is illegal to charge or accept any portion of a fee for which no services have actually been performed, whereas under *Krzalic*, a settlement service provider is free to charge as much as it wants for items such as credit reports, mailing fees, recording documents and a host of other "incidental charges."

Tolerance of such overcharges will allow settlement service providers to purposely "upcharge" borrowers as they see fit with regard to numerous different charges, making it impossible for borrowers to determine what the real price of Republic's services is and thwarting competition. Of course, providers of such services are free to increase their stated "closing fee"– the agreed for price of this service – if they feel that the market will bear it. They should not however, be free to hide such increases in their prices by inflating amounts which they represent are paid out to third parties.

The *Krzalic* decision provides a disincentive for settlement service providers to be honest about the actual costs they incur and in fact, encourages them to dishonestly mark up third party fees. It allows them to keep their "basic" fee deceptively low while they gouge borrowers by consistently tacking on twenty dollars here and there. This is obviously contrary to the purpose and intent of RESPA and the courts should not allow Congress's intentions to be thwarted in such a way.

It has been almost thirty years since the passage of RESPA. However, RESPA's goal of providing consumers with greater and more timely information on the nature and costs of the settlement process and protecting consumers from unnecessarily high settlement costs caused by abusive lending practices is as important today as it was in 1974. Unfortunately, *Krzalic* undermines this purpose by holding that settlement service providers may mark up third party fees, under the guise of legitimate third party charges, as much as they desire, leaving consumers no recourse. RESPA's mechanism for deterring lenders and settlement service providers from gouging borrowers with regard to the charges for such fees has been rendered virtually useless by the *Krzalic* decision.

Under Supreme Court Rule 10(c), this Court can consider unresolved questions that are extremely important. As shown above, RESPA remains one the most important consumer protection laws enacted by Congress. Due to the importance of the question presented, the conflict between the Circuits, and its profound effect on everyday life, petitioners respectfully submit that this Court should review this matter.

II.

THE DECISION OF THE COURT OF APPEALS IS ERRONEOUS.

A. The *Krzalic* Decision Conflicts With RESPA.

RESPA § 8(b) makes it unlawful to receive of a fee, or even a portion of a fee, other than for services actually performed. 12 U.S.C. § 2607(b). The intent of Congress has always been to include unearned fees as among the various types of violations. This is further emphasized by the language in Regulation X. It explains that "[a] charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section." 12 C.F.R 3500.14.

The instructions regarding how the Settlement Statement is to be filled out require that the settlement statement "itemize all charges imposed upon the Borrower and the Seller by the Lender . . . and any other charges which either the Borrower or the Seller will pay for at settlement" *and* "[f]or all items except for those paid to and retained by the Lender, the name of the person or firm ultimately receiving the payment should be shown." 24 C.F.R. 3500, App. A. In other words, Republic's compensation must be disclosed as such and the amounts it represents will be

disbursed to the Recorder must be disbursed to the Recorder. Republic may not disclose that it is charging $250 for closing a deal and actually get $300 by marking up third party disbursements. Republic disclosed the charges at issue under the "government charges" section as recording fees. By charging the Krzalics higher amounts for recording fees than were actually disbursed as such, Republic accepted a fee for services which it did not perform.

The Seventh Circuit rejected this interpretation, just as it did in *Echevarria*. It interprets the phrase "No person shall give and no person shall accept any portion, split, or percentage of any charge" as requiring that, in order to commit a violation, collaboration with some other party in charging the excessive fee and sharing in the "profit."

Petitioners' interpretation of RESPA is simple, reasonable and reinforced by Regulation X, HUD's Policy Statement and the underlying intent of Congress. As shown above, Regulation X explains that fees for which no services are performed are violative of Section 8(b). Further, HUD has *always* maintained that as well as taking or receiving a kickback, it "is also illegal to charge or accept a fee or part of a fee where no service has actually been performed." 41 Fed.Reg. 20, 280, 20,289 (1976). This view is *not* new. A statute which was enacted to protect consumers from being overcharged could not reasonably be interpreted to have meant to allow such a charge.

B. The *Krzalic* Decision Conflicts With the Department of Housing and Urban Development's "Formal Commitment" to Its Position That a "Split" is Not Required For a Court to Find a Violation of RESPA.

12 U.S.C. § 2617 authorizes HUD to adjust the scope of RESPA if "necessary to achieve the purposes of this Act." Section 2617(a) states that "The Secretary is authorized to prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of this Act."

In *Echevarria*, the Seventh Circuit explicitly stated that it was disinclined to overrule prior law requiring a "split" "[a]bsent a formal commitment by HUD to an opposing position." 256 F.3d at 630.

Subsequent to the *Echevarria* ruling HUD *did* issue such a commitment. On October 18, 2001, HUD issued a formal Policy Statement. Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b), 66 FR 53052-01 (hereinafter "the Policy Statement"). It specifically addresses charges of the type imposed in the present case and declares that a "split" is not required for an overcharge to amount to a violation of RESPA.

Speaking of *Echevarria* and another similar case (*Willis v. Quality Mortgage USA, Inc.*, 5 F.Supp.2d 1306 (Ala. 1998)) in the 2001 Policy Statement, HUD stated that it "disagree(d) with these judicial interpretations of Section 8(b)

which it regards as inconsistent with HUD's regulations and HUD's long-standing interpretations of Section 8(b)." HUD 2001 Policy Statement, 16). The HUD 2001 Policy Statement continues:

> **Inasmuch as Section 8(b)'s proscription against "any portion, split, or percentage" of an unearned charge for settlement services is written in the disjunctive, the prohibition is not limited to a split. In HUD's view, Section 8(b) forbids the paying or accepting of any portion or percentage of a settlement service--including up to 100%--that is unearned, whether the entire charge is divided or split among more than one person or entity or is retained by a single person. Simply put, given that Section 8(b) proscribes unearned portions or percentages as well as splits, HUD does not regard the provision as restricting only fee splitting among settlement service providers.**
>
> **...**
>
> **A settlement service provider may not levy an additional charge upon a borrower for another settlement service provider's services without providing additional services that are bona fide and justify the increased charge. Accordingly, a settlement service provider may not mark-up the cost of another provider's services without providing additional settlement services; such payment must be for services that are actual, necessary and distinct services**

provided to justify the charge. 24 CFR 3500.14(g)(3).

The Department of Justice even filed a brief as *Amicus Curiae* supporting reversal, explaining that the unearned fee at issue has long been considered a RESPA violation by HUD and urging the Seventh Circuit to reconsider.

In light of RESPA and the HUD 2001 Policy Statement, the Seventh Circuit should have held that Republic's conduct violated RESPA.

C. The *Krzalic* Decision Conflicts With this Court's Ruling in the *Chevron* case.

The Seventh Circuit further erred by refusing to follow the decision in *Chevron, USA, Inc. v. Natural Res. Defense Council, Inc.*, 467 U.S. 837, 842 (1984). Under the circumstances, *Chevron* requires that the intent of Congress, which has been clearly iterated above, be respected.

Chevron requires that if a statute is ambiguous a court should defer to the reasonable interpretation of the agency charged with its administration. *Id.* By explicitly stating that it will not overrule prior law requiring a "split" "[a]bsent a formal commitment by HUD to an opposing position," the Seventh Circuit itself indicated that it found § 8(b) to be ambiguous. *Echevarria* 256 F. 3d 623, 630 (7th Cir. 2001). If it did not view § 8(b) as ambiguous, it would not have stated a willingness in the future to revise its § 8(b) jurisprudence in accordance with HUD's interpretation of § 8(b).

Congress specifically authorized HUD to "prescribe such rules and regulations, to make such interpretations, and

to grant such reasonable exemptions for classes of transactions, as may be necessary". 12 U.S.C. § 2617(a). Congress clearly intended to give HUD broad power to fill any gaps in the legislation and subsequent regulations. Pursuant to that enabling statute (12 U.S.C. § 2617(a)), HUD has adopted its policy statement. Under *Chevron*, therefore, the Seventh Circuit should have paid proper credence to the Policy Statement and interpreted §8(b) as HUD interprets §8(b), namely that it is a violation of RESPA to accept a fee in connection with a real estate settlement when that party has not actually earned that fee.

Rather than grant proper deference under *Chevron*, the Seventh Circuit improperly created a new category of deference most properly called "sub-Chevron deference." In doing so, the Seventh Circuit reasoned that:

> "Chevron, in effect equating statutory interpretation to policymaking (cf. Hans Kelsen, *Pure Theory of Law* 351-353 (Max Knight trans. 1967)), hands over (with certain qualifications) interpretative responsibility to the officials responsible for making policy judgments, when the ordinary interpretive tools used by the courts, such as textual interpretation, do not work well.
>
> By taking this position the Court appears to have shifted power from the legislative to the executive branch, and the so-called "independent" administrative agencies as well, bu limiting judicial authority to preserve the deal struck by contending interest groups in the original legislation. For while in principle Congress can step in and curb a straying

> agency, the practice is often different because of obstacles to legislating that are built into the federal legislative process, including bicameralism and the Presidential veto. William N. Eskridge, Jr. *Dynamic Statutory Interpretation* 164-67 (1994); Jonathan T. Molot, "Reexamining *Marbury* in the Administrative State: A Structural and Institutional Defense of Judicial Power Over Statutory Interpretation," 96 *Nw. U.L. Rev.* 1239, 1282 (2002); see also William N. Eskridge, Jr. & John Ferejohn, "The Article I, Section 7 Game," 80 Geo. L.J. 523, 538-43 (1992). These obstacles give agencies a degree of running room"

The Seventh Circuit's failure to properly apply *Chevron* is, in itself, appropriate grounds for reversal.

III.

THERE IS A CONFLICT AMONG THE FEDERAL CIRCUIT COURTS.

Supreme Court Rule 10(a) provides that a factor favoring certiorari is that "a United States court of appeals has entered a decision in conflict with the decision of another United States court of appeals on the same important matter." *See also, Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 393 (1923). The Seventh Circuit has reached a conclusion opposite of that reached by the Eighth, Ninth and Eleventh Circuits on one of the issues presented in this case – whether HUD's Policy Statement is entitled to deference.

In *Heimmermann v. First Union Mortgage Corp.*, 305 F.3d 1257 (11th Cir. 2002), borrowers brought suit for an alleged payment of an illegal referral fee to mortgage brokers in connection with numerous loans. Although the plaintiffs in *Heimmermann* complained of a "yield spread premium" rather than the overcharge for recording fees which is at issue here, just as in the present case, resolution of the issue was dependent upon the Statement of Policy issued by HUD.

The Eleventh Circuit found that HUD's policy statement is entitled to deference. The Court noted, citing this Court's opinion in *United States v. Mead Corp.*, 533, U.S. 218, 121 S.Ct. 2164, 150 L.Ed.2d 292 (2001), that *Chevron* deference is appropriate "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority."*Heimmermann,* 305 F.3d 1257, 1261.

RESPA contains an express delegation of congressional authority: the statute authorizes the Secretary of HUD "to prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of this chapter," 12 U.S.C. §2617(a) (emphasis added) and the HUD regulations identify a "statement of policy" as a document that embodies such a "rule, regulation or interpretation" under RESPA's delegation of authority. *Heimmermann,* 305 F.3d 1257, 1261 *citing* C.F.R. §3500.4(a)(1)(ii). Therefore, the Eleventh Circuit found that the power to issue interpretations is expressly delegated in RESPA and that the 2001 Statement of Policy carries the full force of law. *Id.*

In *Schuetz v. Banc One Mortgage Corp.*, 292 F.3d 1004 (9th Cir. 2002), the Ninth Circuit held that *Chevron* deference is due even though HUD's Policy Statements are not the result of formal rulemaking or adjudication. *Id.* at1012. The court explained that RESPA authorizes HUD to interpret the statute, 12 U.S.C. 2617(a), and HUD's regulations indicate that a "statement of policy" published in the Federal Register constitutes a "rule regulation or interpretation" for purposes of RESPA. *Id. Citing* C.F.R. §3500.4(a)(1)(ii). The Ninth Circuit readily distinguished *Christensen v. Harris County*, 529 U.S. 576, 120 S.Ct. 1655 (2000) in which this Court found that interpretations such as those in opinion letters–like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law–do not warrant *Chevron*-style deference. The court properly reasoned that "HUD's Policy Statements are different because Congress authorized the Department to interpret RESPA, HUD has the responsibility for enforcing the statute, and it has expertise in the home mortgage lending industry." *Schuetz*, 292 F.3d at 1012. The Ninth Circuit also followed this reasoning as recently as March of this year in *Bjustrom v. Trust One Mortgage Corp.*, 2003 WL 1343585 (9th Cir.Ct.App. Mar. 20, 2003).

Krzalic is factually similar to both *Heimmermann* and *Schuetz*. The *Krzalic* petitioners obtained a mortgage loan for which the respondent acted as the closing agent. Petitioners alleged that they were overcharged for settlement services in connection with a residential real estate transaction. Although the plaintiffs in *Heimmermann* and *Schuetz* complained of "yield spread premiums" rather than overcharging for recording fees, each of the cases required the deciding court to consider the 2001 Policy Statement issued by HUD. However, unlike the Eleventh and Ninth Circuits, the Seventh

Circuit failed to give proper deference to the Policy Statement.

Even the Eighth Circuit, in *Glover v. Standard Federal Bank*, 283 F.3d 953 (8th Cir. 2002) found that the Policy Statement issued by HUD, setting out a two step test for determining what fees may be paid by lenders to mortgage brokers under RESPA, was entitled to deference. The court reasoned that the statements interpreted HUD's own ambiguous regulation, which did nothing more than mirror the ambiguous language of the statute, and since the policy statements reflected a reasoned view of a responsible agency which was consistent with the statute and the regulation and which constituted a body of experience and informed judgment that the Court of Appeals could look to as determinative authority. *Real Estate Settlement Procedures Act of 1974*, §8 (a, c), as amended, 12 U.S.C.A. 2607 §2607 (a, c); 24 C.F.R. §§3500.1 et seq.; *Glover v. Standard Federal Bank*, 283 F.3d 953 (8th Cir. 2002)

As can be seen, the Seventh Circuit has reached a conclusion opposite of that which was reached by the Eighth, Ninth and Eleventh Circuits on the same issue. In light of this split of authority and the resulting inconsistencies which will follow, petitioners respectfully submit that this Court should review this matter and render a decision to be followed in all Circuits.

CONCLUSION

For the reasons above, petitioners respectfully request that this Court grant their petition for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 02-2285

[Filed December 26, 2002]

NEDZAD KRZALIC and DANIJELA KRZALIC,
Plaintiffs-Appellants,

v.

REPUBLIC TITLE CO.,
Defendant-Appellee.

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division
No. 01 C 9979
Charles P. Kocoras, Chief Judge

JUDGES
Before BAUER, POSNER, and EASTERBROOK, Circuit Judges.

OPINION

POSNER, *Circuit Judge*. Section 8(b) of the Real Estate Settlement Procedures Act, 12 U.S.C. § 2607(b), provides that "no person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed." The plaintiffs in this class action suit contend that the defendant, the closing agent in their purchase of a home, charged them $50 for recording their mortgage yet paid the county recorder only $36. The plaintiffs (who conceded in the district court, but forgot in this court, that they lack standing to challenge a second alleged overcharge, made by the sellers of the house for the release of the previous mortgage) claim that the $ 14 difference pocketed by the defendant represented the receipt of a portion of a charge other than for a service actually performed, and so violated the statutory provision that we quoted.

In *Echevarria v. Chicago Title & Trust Co.*, 256 F.3d 623, 626-28 (7th Cir. 2001), we held, as have other courts, see *Boulware v. Crossland Mortgage Corp.*, 291 F.3d 261, 265-68 (4th Cir. 2002); *Willis v. Quality Mortgage USA, Inc.*, 5 F. Supp. 2d 1306, 1309 (M.D. Ala. 1998), that section 8(b) is an anti-kickback provision. There was no kickback in that case, and there is none here. But in response to our decision, the Department of Housing and Urban Development, which Congress has authorized to "prescribe such regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of" the Act, 12 U.S.C. § 2617(a), issued a policy statement in which, clarifying its previous views on the subject, which had been ambiguous, see, e.g., 24 C.F.R.

3500.14(c); 57 Fed. Reg. 49600, 49605 (Nov. 2, 1992); *Echevarria v. Chicago Title & Trust Co., supra*, 256 F.3d at 627-28, it stated its disagreement with our decision and made clear its view that section 8(b) is not "limited to situations where at least two persons split or share an unearned fee." HUD, *Real Estate Settlement Procedures Act Statement of Policy 2001-1*, 66 Fed. Reg. 53052, 53057 (Oct. 18, 2001). Any repricing of charges, the statement contends, is unlawful. The policy statement was not adopted in a notice and comment rule-making proceeding or with any other deliberative formalities, and the district judge, refusing on that ground to give the statement *Chevron* deference and declare *Echevarria* defunct, granted the defendant's motion to dismiss the suit for failure to state a claim. HUD has filed an amicus brief in this court in support of the plaintiffs' appeal.

When a statute administered by a federal agency is unclear and the agency is authorized to interpret it, the agency's interpretation, unless unreasonable, may bind a reviewing court in accordance with *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-44, 81 L. Ed. 2d 694, 104 S. Ct. 2778 (1984). Ordinarily issues of statutory interpretation are treated as pure issues of law, and no deference is given the interpretation adopted by executive or other officials. But *Chevron*, in effect equating statutory interpretation to policymaking (cf. Hans Kelsen, *Pure Theory of Law* 351-353 (Max Knight trans. 1967)), hands over (with certain qualifications) interpretive responsibility to the officials responsible for making policy judgments, when the ordinary interpretive tools used by courts, such as textual interpretation, do not work well.

By taking this position the Court appears to have shifted power from the legislative to the executive branch, and to the so-called "independent" administrative agencies as well, by limiting judicial authority to preserve the deal struck by contending interest groups in the original legislation. For while in principle Congress can step in and curb a straying agency, the practice is often different because of the obstacles to legislating that are built into the federal legislative process, including bicameralism and the Presidential veto. William N. Eskridge, Jr., *Dynamic Statutory Interpretation* 164-67 (1994); Jonathan T. Molot, "Reexamining *Marbury* in the Administrative State: A Structural and Institutional Defense of Judicial Power Over Statutory Interpretation," 96 *Nw. U.L. Rev.* 1239, 1282 (2002); see also William N. Eskridge, Jr. & John Ferejohn, "The Article I, Section 7 Game," 80 *Geo. L.J.* 523, 538-43 (1992). These obstacles give agencies a degree of running room.

Small-d democrats might question *Chevron*'s shift of legislative power to the bureaucracy. But realists, while acknowledging the point and also that it is a fiction to suppose *Chevron* itself an interpretation of the statutes to which it applies or that the exercise of power by appointed officials is democratic merely because it is authorized by elected officials, will applaud the Supreme Court's recognition that the interpretation of an ambiguous statute is an exercise in policy formulation rather than in reading.

Adams Fruit Co. v. Barrett, 494 U.S. 638, 649-50, 108 L. Ed. 2d 585, 110 S. Ct. 1384 (1990), might seem to cast doubt on *Chevron*'s applicability to the Real Estate Settlement Procedures Act, however, because the Court said that "Congress has expressly established the Judiciary and not

the Department of Labor as the adjudicator of private rights of action arising under the statute [a statute for the protection of farm workers]. A precondition to deference under *Chevron* is a congressional delegation of administrative authority . . . . No such delegation regarding AWPA's enforcement provisions is evident in the statute. Rather, Congress established an enforcement scheme independent of the Executive and provided aggrieved farmworkers with direct recourse to federal court where their rights under the statute are violated." RESPA too is enforced by private actions rather than by judicial or administrative proceedings instituted by HUD. But whereas the farm workers' statute had not delegated to the Department of Labor authority to fill gaps in the statute, RESPA explicitly delegates such authority to the Department of Housing and Urban Development, in 12 U.S.C. § 2617(a), which we quoted earlier. Two of the three courts to have considered the question have concluded, albeit without discussion of *Adams Fruit*, that at least some HUD interpretations of RESPA are within the scope of *Chevron*. *Heimmermann v. First Union Mortgage Corp.*, 305 F.3d 1257, 1261-62 (11th Cir. 2002); *Schuetz v. Banc One Mortgage Corp.*, 292 F.3d 1004, 1012 (9th Cir. 2002).

The third court, in *Glover v. Standard Federal Bank*, 283 F.3d 953, 961-63 (8th Cir. 2002), reached a similar result by the old-fashioned route, mapped in *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 89 L. Ed. 124, 65 S. Ct. 161 (1944), of granting the degree of deference that an agency's decision invites by virtue of the cogency of its reasoning in relation to the nature of the issue. The more technical the issue is, the less guidance the statute provides to its correct resolution, the more sensible-seeming the agency's decision, and the more deliberative and empirical the procedures

employed in arriving at that decision, the greater the deference that a reviewing court will give it.

Barnhart v. Walton, 535 U.S. 212, 122 S. Ct. 1265, 1272, 152 L. Ed. 2d 330 (2002), the Supreme Court's most recent decision interpreting *Chevron*, suggests a merger between *Chevron* deference and *Skidmore*'s and *Glover*'s approach of varying the deference that agency decisions receive in accordance with the circumstances: "the interstitial nature of the legal question, the related expertise of the Agency, the importance of the question to administration of the statute, the complexity of that administration, and the careful consideration the Agency has given the question over a long period of time all indicate that *Chevron* provides the appropriate legal lens through which to view the legality of the Agency interpretation here at issue." Or in the words of Professor Pierce, "legislative rules and formal adjudications are always entitled to *Chevron* deference, while less formal pronouncements like interpretative rules and informal adjudications may or may not be entitled to *Chevron* deference. The deference due a less formal pronouncement seems to depend on the results of judicial application of an apparently open-ended list of factors that arguably qualify as 'other indications of a comparable congressional intent' to give a particular type of agency pronouncement the force of law." Richard J. Pierce, Jr., *Administrative Law Treatise* § 3.5, pp. 6-7 (4th ed. Supp. 2003).

We need not penetrate more deeply into this thicket; for even if HUD's interpretations of RESPA are entitled to *Chevron* deference, that deference is not total and as it happens section 8(b) of RESPA will not bear, as a matter of straightforward judicial interpretation (for if such

interpretation dissipates any possible statutory ambiguity and fills any possible gap in the statute, *Chevron* deference is not owed), the meaning that HUD wants to give it. Republic Title did not "accept any portion, split, or percentage of any charge." No one agreed to divide a receipt with Republic. The statutory language describes a situation in which *A* charges *B* (the borrower) a fee of some sort, collects it, and then either splits it with *C* or gives *C* a portion or percentage (other than 50 percent -- the situation that the statutory term "split" most naturally describes) of it. *A* might be a lawyer, and *C* a closing agent like Republic Title, and *A* might charge a legal fee to *B* and kick back a share of it to *C* for recommending to the borrower that he use *A*'s services. That would be a form of commercial bribery and is the target of section 8(b). Republic, however, received no part of a fee charged by someone else. The plaintiffs' beef is that the county recorder did *not* charge $50 to record their mortgage; and so he could not have divided it with Republic. Recall, too, that the statute forbids the giving as well as the receiving of any portion, split, or percentage. On the plaintiffs' understanding, they themselves violated the statute because they gave Republic a portion of the fee charged by the county recorder!

In *United States v. Gannon*, 684 F.2d 433, 435-36 (7th Cir. 1981) (en banc), the strongest case for HUD and the plaintiffs but not strong enough, a county clerk charged more than the stated fee and kept the difference. He was accepting in his personal capacity a portion of the fee that he was imposing in his official capacity. It was as if he had kicked back the difference to Republic.

Usually when a statutory provision is clear on its face the court stops there, in order to preserve language as an effective medium of communication from legislatures to courts. If judges won't defer to clear statutory language, legislators will have difficulty imparting a stable meaning to the statutes they enact. But if the clear language, when read in the context of the statute as a whole or of the commercial or other real-world (as opposed to law-world or word-world) activity that the statute is regulating, points to an unreasonable result, courts do not consider themselves bound by "plain meaning," but have recourse to other interpretive tools in an effort to make sense of the statute. E.g., *Public Citizen v. U.S. Dept. of Justice*, 491 U.S. 440, 453-55, 105 L. Ed. 2d 377, 109 S. Ct. 2558 (1989); *Green v. Bock Laundry Machine Co.*, 490 U.S. 504, 527, 104 L. Ed. 2d 557, 109 S. Ct. 1981 (1989) (Scalia, J., concurring); *AM Int'l, Inc. v. Graphic Management Associates, Inc.*, 44 F.3d 572, 577 (7th Cir. 1995); Veronica M. Dougherty, "Absurdity and the Limits of Literalism: Defining the Absurd Result Principle in Statutory Interpretation," 44 *Am. U.L. Rev.* 127 (1994). They do not want to insult the legislature by attributing absurdities to it.

In this case, however, context *reinforces* the implications of the statutory language. On the plaintiffs' and HUD's view, section 8(b) forbids a lender or closing agent to reprice any of the charges that it has incurred and is passing on to the borrower. This would make sense if RESPA were a public-utility or other rate-regulating statute, but it is not. The statute places no ceiling on the amount that a closing agent can charge for its services. At the closing on the Krzalics' real estate transaction, Republic charged them a closing fee of $315 plus various expenses that included the

$50 recording fee. Had Republic charged the Krzalics only the actual recording fee of $36, it could have raised its closing fee to $329 and be in the identical economic position that it was in with the repricing of the fee. The plaintiffs and HUD argue that Republic would have been reluctant to do this because then the plaintiffs might have taken their business to a closing agent that charged a lower closing fee. But all that borrowers care about is the bottom line -- which in this case was approximately $165,000 -- and that would not have been affected by which line contained the $14; the sum of $315 and $50 is identical to the sum of $329 and $36. If borrowers are as price conscious as the Krzalics claim to be (and more power to them), then their lawyers (for the Krzalics were represented by counsel at the closing), who know what the county recorder charges for routine services, will shop for closing agents who neither reprice such charges nor make compensating upward adjustments in their closing fees.

Nothing is more common than for professionals to reprice the incidental charges that they incur on behalf of their clients. Law firms, for example, typically reprice their copying expenses in their bills to their clients. The client is not hurt because he can easily find out what those expenses actually were, and so it is with the government's charges for routine services in connection with real estate transactions -- the charges are not secret. If the real estate settlements industry is competitive, a member of the industry cannot increase the market price for its services by how it allocates its overhead among the different components of its invoices. What is more, if the effect of the plaintiffs' suit were to induce closing agents like Republic to defer levying the charge for recording until it did the recording and thus knew

the exact fee, it would be more rather than less difficult for consumers to comparison shop among closing agents.

Maybe, though, there is some hanky-panky going on here that we are missing by assuming away costs of information. When asked at argument why his client reprices the recording fee, Republic's lawyer answered that the precise fee is not known until the documents are recorded, and that occurs after the closing. True, but it's easy enough to estimate within pennies. A visit to the Cook County recorder's Web site reveals that the fee for recording a mortgage is $23 for the first two pages and $2 for each additional page plus 50 cents for service by return mail; so for the eight-page mortgage involved here, the total fee could readily be estimated at $35.50, which is well short of the $50 that Republic charged. And anyway Republic does not refund any overcharge that emerges when the precise fee is learned. Still, to repeat an earlier point, we have difficulty seeing what difference it can make to the consumer where the $14 "overcharge" appears on the closing statement. And if there is a fraud here, there are plenty of legal remedies, though none so far as we know under RESPA.

But the most important point is that if the practice of repricing incidental charges is a fraud or market failure or abuse of some sort, still it is not a market failure that section 8(b) can reasonably be thought to address, and so a reading of the section that leaves the failure uncured is not a reading that creates a loophole. If RESPA were a price-control statute a loophole would be opened if the firms subject to the statute were allowed to mark up cost items in their bills to whatever height they wanted. It is not a price-control statute.

There is not enough play in the statutory joints to allow HUD to impose its own "interpretation" under the aegis of *Chevron*. But there is a further point. If an agency is to assume the judicial prerogative of statutory interpretation that *Chevron* bestowed upon it, it must use, not necessarily formal adjudicative procedures or its closest nonadjudicative counterpart, which is notice and comment rule-making (as in *Sierra Club v. EPA*, 311 F.3d 853, 858 (7th Cir. 2002)), but, still, something more formal, more deliberate, than a simple announcement. *See Barnhart v. Walton*, *supra*, 122 S. Ct. at 1271-72; *United States v. Mead Corp.*, 533 U.S. 218, 229-31, 150 L. Ed. 2d 292, 121 S. Ct. 2164 (2001). A simple announcement is too far removed from the process by which courts interpret statutes to earn deference. A simple announcement is all we have here. One fine day the policy statement simply appeared in the Federal Register. No public process preceded it -- or at least the part of it that concerns section 8(b), for the policy statement deals with other matters as well.

The qualification is important. In 1999 HUD had issued a policy statement concerning yield-spread premiums (a method of spreading the normal up-front closing costs over the life of the mortgage) after meeting with government representatives plus a broad range of consumer and industry groups. 64 Fed. Reg. 10080, 10084 (Mar. 1, 1999). And both that statement and a portion of the 2001-1 statement (the one on which HUD and the plaintiffs rely here) that further addressed the issue of yield-spread premiums contain a full discussion of that issue. But the discussion in the 2001-1 statement of the unearned-fees (i.e., section 8(b)) issue is perfunctory. It expresses disagreement with our decision in *Echevarria* but gives no reason except that HUD has always

regarded such fees as forbidden by the statute, though previously it had failed to make this clear. No evidence or interpretive methodology is mentioned; no abuse pointed to that might justify the contorted interpretation urged by HUD. Its amicus brief alarmingly warns that repricing is "putting home ownership beyond the reach of many Americans," that "HUD is currently investigating over 100 complaints," and that if we don't adopt its interpretation we will be permitting "unscrupulous providers to inflate settlement charges without limit." None of this appears in the policy statement, perhaps because it is silly; a $14 overcharge (if that is how it should be viewed) in a $165,000 purchase is not going to make the difference between owning and renting. It is no surprise that *Heimmermann*, *Schuetz*, and *Glover*, the three decisions we cited earlier that defer to HUD interpretations, all dealt with the part of the 2000-1 statement that concerns yield-spread premiums.

AFFIRMED.

CONCUR

EASTERBROOK, *Circuit Judge*, concurring in part and concurring in the judgment. I join my colleagues' opinion except for those portions that discuss *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 81 L. Ed. 2d 694, 104 S. Ct. 2778 (1984). The Real Estate Settlement Practices Act is enforced entirely through private litigation, and *Adams Fruit Co. v. Barrett*, 494 U.S. 638, 649-50, 108 L. Ed. 2d 585, 110 S. Ct. 1384 (1990), holds that, when this is true, the view of a federal agency achieves binding force only when incorporated into legislative regulations issued under delegated power. The Department of

Housing and Urban Development has the power to prescribe regulations, see 12 U.S.C. § 2617(a), but elected instead to announce its interpretation of the statute. It issued a broadside and hoped that courts would kowtow. Yet in private litigation *Chevron* does not give any force to a declaration unaccompanied by the formalities of rule-making or administrative adjudication. See also *United States v. Mead Corp.*, 533 U.S. 218, 150 L. Ed. 2d 292, 121 S. Ct. 2164 (2001). Otherwise the Administrative Procedure Act, which specifies how delegated power is to be exercised, would be a dead letter. When an agency doles out public funds and is a party to the suit, less formal steps may have legal effects, see *Barnhart v. Walton*, 535 U.S. 212, 152 L. Ed. 2d 330, 122 S. Ct. 1265 (2002), but ours is not such a situation. If the agency abjures the APA's procedures for making decisions, courts owe the administrative interpretation careful attention, see *Skidmore v. Swift & Co.*, 323 U.S. 134, 89 L. Ed. 124, 65 S. Ct. 161 (1944), but nothing more. "Interpretations contained in policy statements . . . which lack the force of law do not warrant *Chevron*-style deference." *Christensen v. Harris County*, 529 U.S. 576, 587, 146 L. Ed. 2d 621, 120 S. Ct. 1655 (2000); see also *EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 256-58, 113 L. Ed. 2d 274, 111 S. Ct. 1227 (1991). I do not perceive in *Walton* any "merger" (slip op. 5) between *Chevron* and *Skidmore*, which *Mead* took such pains to distinguish. HUD's interpretation is on the *Skidmore* side of the line.

Surprisingly, two circuits have treated HUD's *Real Estate Settlement Procedures Act Statement of Policy 2001-1*, 66 Fed. Reg. 53052 (Oct. 18, 2001), as equivalent to a regulation. See *Heimmermann v. First Union Mortgage Corp.*, 305 F.3d 1257, 1261 (11th Cir. 2002); *Schuetz v.*

Banc One Mortgage Corp., 292 F.3d 1004, 1012 (9th Cir. 2002). Yet neither opinion discusses the significance of *Adams Fruit* or *Christensen* in relation to the agency's disregard of those procedures that the APA establishes for the exercise of regulatory authority. *Heimmermann*, *Schuetz*, and a related decision, *Glover v. Standard Federal Bank*, 283 F.3d 953, 963-65 (8th Cir. 2002), concern the treatment of yield-spread premiums under the RESPA, and I have nothing to say about the legal status of that practice. As *Glover* observes, HUD has issued regulations about yield-spread premiums, and the policy statement may be understood as an interpretation of those regulations, which do have binding status. But I am confident that *Heimmermann* and *Schuetz* erred in thinking that the *Real Estate Settlement Procedures Act Statement of Policy 2001-1* is itself conclusive under *Chevron*, as opposed to informative (and potentially persuasive).

Boulware v. Crossland Mortgage Corp., 291 F.3d 261 (4th Cir. 2002), holds, and all members of this panel agree, that HUD's interpretation of § 8(b), 12 U.S.C. § 2607(b), finds no purchase in the statutory text, is essentially unreasoned, and is neither informative nor persuasive. Section 8 is an anti-*kickback* rule, not an anti-*markup* rule. It does not forbid profit and could not do so, given the closing agent's unfettered ability to set a price for the package of services it offers. See *Mercado v. Calumet Federal Savings & Loan Ass'n*, 763 F.2d 269 (7th Cir. 1985). It would make neither linguistic nor economic sense to describe the difference between wholesale and retail price in the auto business as a "portion, split, or percentage of any charge" because the dealer must pay the manufacturer for inventory. Just so in real estate closings: The Recorder of Deeds' fee is Republic

Title's wholesale price for a service; Republic's retail price is higher. Republic bears the costs of transferring the deed to the Recorder; it must pay the salary of employees who process the papers, and maybe it pays a messenger service too. The markup covers these and other costs, such as the bank's fees on the checks written to the Recorder, the cost of capital used to run the business, and the risk that some deeds may be so lengthy that the Recorder's fees will top the charge. Whether or not the $50 exceeds all costs associated with getting the deed filed, nothing has been "split" or kicked back. Services were furnished as described: the deed was filed, and the closing agent performed (and bore the cost of) all the ministerial acts essential to accomplish filing. By announcing that the RESPA forbids markups over wholesale price, HUD has gone off on a tangent. It might as well have said that the salary paid to the closing agent's staff, or the rent paid to the landlord for space used in the closing, is an illegal "split" of funds received from the customer.

All of this makes *Chevron* by the by, so it is surprising that my colleagues go out of their way to suggest that its approach is undemocratic and that statutory interpretation is just policymaking by another name. In what sense could it be "undemocratic" to have statutory ambiguities resolved, and gaps filled, by elected officials (and those who serve at their pleasure) rather than by judges whose tenure insulates them from the popular will? What is more, textualists are among *Chevron*'s supporters, an odd position if the decision adopts the view that legal texts are empty vessels to be filled by judges (or administrators). All *Chevron* does is acknowledge that decision-making authority is shared among branches of government; it does not imply that the only sensible interpretive stance is pragmatic rather than textualist. Nor

does *Chevron* surreptitiously transfer authority from the legislative to the executive branch of government. Agencies' interpretive role stems from delegation of authority, not raw ambiguity. That's one reason why *Chevron* does not require courts to implement "interpretations" that agencies announce without following the APA's requirements for rule-making: following forms is a condition attached to the delegation.

Interpretation differs fundamentally from regulation. Judges do not apply *Chevron* to the Attorney General's interpretation of the Sherman Antitrust Act, whether in public or in private litigation, although the antitrust statutes are notoriously open-ended. Nor do courts accept under *Chevron* the prosecutor's interpretation of ambiguous criminal statutes such as RICO. *Chevron* itself says that delegation is the key; *Adams Fruit* and *Mead* drive the point home. When the holder of a delegated power wields that authority, the legislative plan has been fulfilled, not frustrated. Congress can choose to delegate, or not, statute-by-statute or through framework laws such as the APA; it could undo *Chevron* across the board if the doctrine functioned as kryptonite to its enactments. All that matters today, however, is that when the executive branch does not employ regulatory power delegated by the legislative branch, resolution of ambiguities in private litigation belongs to the judicial branch.

APPENDIX B

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

No: 01 C 9979

[Filed May 17, 2002]

NEDZAD KRZALIC and)
DANIJELA KRZALIC,)
Plaintiffs,)
)
v.)
)
REPUBLIC TITLE COMPANY,)
Defendant.)

MEMORANDUM OPINION

CHARLES P. KOCORAS, District Judge:

This matter comes before the court on the motion to dismiss of Defendant Republic Title Company ("Republic") pursuant to Fed. R. Civ. Proc. 12(b)(1) and 12(b)(6). For the reasons set forth below, the motion is granted.

BACKGROUND

Plaintiffs Nedzad and Danijela Krzalic ("the Krzalics") bought a condominium in September 2001. Republic was the closing agent for the transaction. In connection with the closing, Republic charged the Krzalics $75 to record the mortgage and release, even though the County Recorder charges only $59 to record those two documents. Republic then retained the $16 difference. The Krzalics filed suit, contending that Republic's actions violated § 8(b) of the Real Estate Settlement Procedures Act ("RESPA"), codified at 12 U.S.C. §§ 2601-2617. The complaint also includes two state law claims.

Repulic now moves to dismiss the RESPA claim pursuant to Fed. R. Civ. Proc. 12(b)(6) and the state law claims pursuant to Fed. R. Civ. Proc. 12(b)(1).

LEGAL STANDARD

The purpose of a motion to dismiss under Rule 12(b)(6) is to test the legal sufficiency of a complaint. *Triad Associates, Inc. v. Chicago Hous. Auth.*, 892 F.2d 583, 586 (7th Cir. 1989). In ruling on a motion to dismiss, the court must construe the allegations of the complaint in the light most favorable to the plaintiff, and all well-pleaded facts and allegations in the complaint must be accepted as true. *Bontkowski v. First Nat'l Bank of Cicero*, 998 F.2d 459, 461 (7th Cir. 1993).

The allegations of a complaint should not be dismissed for failure to state a claim "unless it appears beyond a doubt that the plaintiff can prove no set of facts in support of his

claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957). Nonetheless, in order to withstand a motion to dismiss, a complaint must allege facts sufficiently setting forth the essential elements of the cause of action. *Lucien v. Preiner*, 967 F.2d 1166, 1168 (7th Cir. 1992).

Jurisdiction is the "power to decide" and must be conferred upon a federal court. *In re Chicago, Rock Island & Pacific R.R. Co.*, 794 F.2d 1182, 1188 (7th Cir. 1986). Pursuant to Fed. R. Civ. Proc. 12(b)(1), a defendant may move to dismiss claims over which the federal court lacks subject matter jurisdiction. When jurisdictional allegations are questioned, the plaintiff has the burden of proving that the jurisdictional requirements have been met. *Kontos v. Dept. of Labor*, 826 F.2d 573, 576 (7th Cir. 1987). With these principles in mind, we turn to Republic's motion.

DISCUSSION

The specific provision at issue in this case, § 8(b), and its implementing regulation, Regulation X, state that providers of settlement services cannot split any fee or charge other than for services actually rendered during the settlement process. 12 U.S.C. § 2607(b), 24 C.F.R. § 3500.14(c). According to the Seventh Circuit, a violation of this section must involve a division of unearned fees or charges by at least two parties; it does not include overcharging by a single party. *Echevarria v. Chicago Title & Trust*, 256 F.3d 623, (7th Cir. 2001); *see also Durr v. Intercounty Title Co.*, 14 F.3d 1183 (7th Cir. 1993); *Mercado v. Calumet Fed. Sav. & Loan Ass'n*, 763 F.2d 269, 270-71 (7th Cir. 1985). The Krzalics disagree with this interpretation and argue that Republic's

actions are indeed illegal under § 8(b) and Regulation X. They look in part to a sentence within Regulation X that in isolation supports their interpretation. However, the Court of Appeals rejected this argument, concluding that, when read in context of the entire regulation, the amendment did not dictate a departure from the line of precedent established in *Durr* and *Mercado*. *Echevarria*, 256 F.3d 623 at 629-30.

Undaunted, the Krzalics point to a passage within the *Echevarria* opinion implying that the Court of Appeals would overrule its prior position on the proper interpretation of § 8(b) if HUD made a formal commitment to an opposing position." 256 F.3d at 630. The Krzalics insist that a policy statement issued by HUD in October 2001 fits this bill, apparently because the statement directly references *Echevarria* and expresses the Secretary's differing interpretation of that section and Regulation X. 66 Fed. Reg. 53052-01.

The argument the Krzalics advance rests on a faulty premise. They imply that the Secretary's specific and strong disagreement with *Echevarria* and the Seventh Circuit's interpretation of § 8(b) and Regulation X is the formal commitment that the Court found lacking in *Echevarria*. The operative word in the applicable passage, however, is "formal," not "commitment." As the Supreme Court reminded in *Christensen v. Harris Cty.*, policy statements issued by an agency, while entitled to respect, do not have the force of law because they are not subjected to the notice and comment requirements for formal rulemaking. 529 U.S. 576, 146 L. Ed. 2d 621, 120 S. Ct. 1655, 1662-63 (2000). Indeed, prior to *Echevarria*, HUD had issued policy statements stating, albeit in less forceful and direct language, the very

position that the Krzalics take in this case. Those statements failed to persuade the *Echevarria* court that the previous stance must be altered, and this new statement likewise does nothing to change the legal landscape for cases such as this within our Circuit. Accordingly, we conclude that *Echevarria* still provides the controlling law for actions that do not involve an unearned fee split by two or more parties. The Krzalics have alleged a situation identical to that held insufficient to support a claim for relief in that case; Count I therefore cannot survive Republic's 12(b)(6) challenge.

The remaining two counts rest solely on state law. Although the Krzalics contend that we should retain jurisdiction over these claims even in the face of the dismissal of Count I, we are unpersuaded that that is the proper course of action. Accordingly, Republic's 12(b)(1) motion to dismiss Counts II and III is granted.

CONCLUSION

Based on the foregoing analysis, we dismiss the complaint in its entirety.

/s/_____
Charles P. Kocoras
United States District Judge

Dated: May 16, 2002

JUDGMENT IN A CIVIL CASE

Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS HEREBY ORDERED AND ADJUDGED that the complaint is dismissed in its entirety.

Michael W. Dobbins, Clerk of Court

/s/_____
Stephen C. Tokoph
Deputy Clerk

Date: 5/16/2002

APPENDIX C

RULES and REGULATIONS

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 3500

[Docket No. FR-4714-N-01]

RIN 2502-AH74

Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b)

Thursday, October 18, 2001

66 FR 53052-01
2001 WL 1240492 (F.R.)
(Cite as: 66 FR 53052)

* 53052 AGENCY: Office of the Assistant Secretary for Housing - Federal Housing Commissioner, HUD

ACTION: Statement of Policy 2001-1.

SUMMARY: This Statement of Policy is being issued to eliminate any ambiguity concerning the Department's position

with respect to those lender payments to mortgage brokers characterized as yield spread premiums and to overcharges by settlement service providers as a result of questions raised by two recent court decisions, *Culpepper* v. *Irwin Mortgage Corp.* and *Echevarria* v. *Chicago Title and Trust Co.*, respectively. In issuing this Statement of Policy, the Department clarifies its interpretation of Section 8 of the Real Estate Settlement Procedures Act (RESPA) in Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers (the 1999 Statement of Policy), and reiterates its long-standing interpretation of Section 8(b)'s prohibitions. *Culpepper* v. *Irwin Mortgage Corp.* involved the payment of yield spread premiums from lenders to mortgage brokers. *Echevarria* v. *Chicago Title and Trust Co.* involved the applicability of Section 8(b) to a settlement service provider that overcharged a borrower for the service of another settlement service provider, and then retained the amount of the overcharge.

Today's Statement of Policy reiterates the Department's position that yield spread premiums are not per se legal or illegal, and clarifies the test for the legality of such payments set forth in HUD's 1999 Statement of Policy. As stated there, HUD's position that lender payments to mortgage brokers are not illegal per se does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The legality of yield spread premiums turns on the application of HUD's test in the 1999 Statement of Policy as clarified today.

The Department also reiterates its long-standing position that it may violate Section 8(b) and HUD's implementing regulations: (1) For two or more persons to

split a fee for settlement services, any portion of which is unearned; or (2) for one settlement service provider to mark-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) for one settlement service provider to charge the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

This Statement of Policy also reiterates the importance of disclosure so that borrowers can choose the best loan for themselves, and it describes disclosures HUD considers best practices. The Secretary is also announcing that he intends to make full use of his regulatory authority to establish clear requirements for disclosure of mortgage broker fees and to improve the settlement process for lenders, mortgage brokers, and consumers.

EFFECTIVE DATE: October 18, 2001.

FOR FURTHER INFORMATION CONTACT: Ivy M. Jackson, Acting Director, RESPA/ILS Division, Room 9156, U.S. Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410; telephone (202) 708-0502, or (for legal questions) Kenneth A. Markison, Assistant General Counsel for GSE/RESPA, Room 9262, Department of Housing and Urban Development, Washington, DC 20410; telephone (202) 708-3137 (these are not toll-free numbers). Persons who have difficulty hearing or speaking may access this number via TTY by calling the toll-free Federal Information Relay Service at (800) 877-8339.

SUPPLEMENTARY INFORMATION:

General Background

The Department is issuing this Statement of Policy in accordance with 5 U.S.C. 552 as a formal pronouncement of its interpretation of relevant statutory and regulatory provisions. Section 19(a) (12 U.S.C. 2617(a)) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601-2617) (RESPA) specifically authorizes the Secretary "to prescribe such rules and regulations [and] to make such interpretations * * * as may be necessary to achieve the purposes of [RESPA]."

Section 8(a) of RESPA prohibits any person from giving and any person from accepting "any fee, kickback, or thing of value pursuant to an agreement or understanding, oral or otherwise" that real estate settlement service business shall be referred to any person. See 12 U.S.C. 2607(a). Section 8(b) prohibits anyone from giving or accepting "any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service * * * other than for services actually performed." 12 U.S.C. 2607(b). Section 8(c) of RESPA provides, "Nothing in [Section 8] shall be construed as prohibiting * * * (2) the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed * * *" 12 U.S.C. 2607(c)(2). RESPA also requires the disclosure of settlement costs to consumers at the time of or soon after a borrower applies for a loan and again at the time of real estate settlement. 12 U.S.C. 2603-4. RESPA's requirements apply to transactions

involving a "federally related mortgage loan" as that term is defined at 12 U.S.C. 2602(1).

I. Lender Payments to Mortgage Brokers

The Conference Report on the Department's 1999 Appropriations Act directed HUD to address the issue of lender payments to mortgage brokers under RESPA. The Conference Report stated that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) (12 U.S.C. sec. 2607) in its enactment of RESPA." H. Rep. 105-769, at 260. As also directed by Congress, HUD worked with industry groups, federal agencies, consumer groups and other interested parties in collectively producing the 1999 Statement of Policy issued on March 1, 1999. *64 FR 10080.* Interested members of the public are urged to consult the 1999 Statement of Policy for a more detailed discussion of the background on lender payments to brokers addressed in today's Statement.

HUD's 1999 Statement of Policy established a two-part test for determining the legality of lender payments to mortgage brokers for table funded transactions and intermediary transactions under RESPA: (1) Whether goods or facilities were actually furnished or services were actually performed for the compensation paid and; (2) whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed. In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to the goods, facilities, or services

furnished or performed to determine whether it is legal under RESPA. In the determination of whether payments from lenders to mortgage brokers are permissible under Section 8 of RESPA, the threshold question is whether there were goods or facilities actually furnished or services actually performed for the total compensation paid to the mortgage broker. Where a lender payment to a mortgage broker comprises a portion of total broker compensation, the amount of the payment is not, under the HUD test, scrutinized separately and apart from total broker compensation.

Since HUD issued its 1999 Statement of Policy, most courts have held that yield spread premiums from lenders to mortgage brokers are legal provided that such payments meet the test for legality articulated in the 1999 Statement of Policy and otherwise comport with RESPA. However, in a recent decision, *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir. 2001), the Court of Appeals for the Eleventh Circuit upheld certification of a class in a case alleging that yield spread premiums violated Section 8 of RESPA where the defendant lender, pursuant to a prior understanding with mortgage brokers, paid yield spread premiums to the brokers based solely on the brokers' delivery of above par interest rate loans. The court concluded that a jury could find that yield spread premiums were illegal kickbacks or referral fees under RESPA where the lender's payments were based exclusively on interest rate differentials reflected on rate sheets, and the lender had no knowledge of what services, if any, the broker performed. The court described HUD's 1999 Statement of Policy as "ambiguous." *Id.* at 1327. Accordingly, and because courts have now rendered conflicting decisions, HUD has an obligation to clarify its

position and issues this Statement today to provide such clarification and certainty to lenders, brokers, and consumers.

Because this clarification focuses on the legality of lender payments to mortgage brokers in transactions subject to RESPA, the coverage of this statement is restricted to payments to mortgage brokers in table funded and intermediary broker transactions. Lender payments to mortgage brokers where mortgage brokers initially fund the loan and then sell the loan after settlement are outside the coverage of this statement as exempt from RESPA under the secondary market exception.

II. Disclosure

Besides establishing the two-part test for determining the legality of yield spread premiums, the 1999 Statement of Policy discussed the importance of disclosure in permitting borrowers to choose the best loan for themselves. The mortgage transaction is complicated, and most people engage in such transactions relatively infrequently, compared to the other purchases they make. In some instances, borrowers have paid very large origination costs, either up front fees, yield spread premiums, or both, which they might have been able to avoid with timely disclosure. Timely disclosure would permit them to shop for preferable origination costs and mortgage terms and to agree to those costs and terms that meet their needs. The Department therefore is issuing a clarification of the importance of disclosure, with a description of disclosures that it considers to be best practices.

In this Statement of Policy, the Secretary is announcing that he intends to make full use of his regulatory

authority as expeditiously as possible to provide clear requirements and guidance prospectively regarding disclosure of mortgage broker fees and, more broadly, to improve the mortgage settlement process so that homebuyers and homeowners are better served. Pending the promulgation of such a rule, the Secretary asks the industry to adopt new disclosure requirements to promote competition and to better serve consumers.

III. Unearned Fees

The 1999 Statement of Policy also touched upon another area of recurring questions under Section 8 of RESPA: the legality of payments that are in excess of the reasonable value of the goods or facilities provided or services performed. See 64 FR 10082-3.

Since RESPA was enacted, HUD has consistently interpreted Section 8(b) and HUD's RESPA regulations to prohibit settlement service providers from charging unearned fees, as occurred in *Echevarria v. Chicago Title & Trust Co.*, 256 F.3d 623 (7th Cir. 2001). Such an interpretation is consistent with Congress's finding, when enacting RESPA, that consumers need protection from unnecessarily high settlement costs. Through this Statement of Policy, HUD makes clear that Section 8(b) prohibits any person from giving or accepting any fees other than payments for goods and facilities provided or services actually performed. Payments that are unearned fees occur in, but are not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider marks-up the cost of the services performed or goods provided by another settlement

service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one settlement service provider charges the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

In a July 5, 2001 decision, the Court of Appeals for the Seventh Circuit concluded that unearned fees must be passed from one settlement provider to another in order for such fees to violate Section 8(b). Accordingly, the court held that a settlement service provider did not violate Section 8(b) when, in billing a borrower, it added an overcharge to another provider's fees and retained the additional charge without providing any additional goods, facilities or services. *Echevarria* v. *Chicago Title & Trust Co.* Other courts have held that two or more parties must split or share a fee in order for a violation of Section 8(b) to occur. Still other courts have stated, however, that a single provider can violate Section 8(b). Because the courts are now divided, HUD is issuing this Statement of Policy to reiterate its interpretation of Section 8(b).

The Court of Appeals for the Seventh Circuit rendered its conclusion in *Echevarria* "absent a formal commitment by HUD to an opposing position. * * *" *Id.* at 630. In issuing this Statement of Policy pursuant to Section 19(a), HUD reiterates its position on unearned fees under Section 8(b) of RESPA, which HUD regards as long standing.

IV. Statement of Policy 2001-1

To give guidance to interested members of the real estate settlement industry and the general public on the application of RESPA and its implementing regulations, the Secretary hereby issues the following Statement of Policy. The interpretations embodied in this Statement of Policy are issued pursuant to Section 19(a) of RESPA. 12 U.S.C. 2617(a).

Part A. Mortgage Broker Fees

Yield Spread Premiums

One of the primary barriers to homeownership and homeowners' ability to refinance and lower their housing costs is the up front cash needed to obtain a mortgage. The closing costs and origination fees associated with a mortgage loan are a significant component of these up front cash requirements. Borrowers may choose to pay these fees out of pocket, or to pay the origination fees, and possibly all the closing fees, by financing them; *i.e.*, adding the amount of such fees to the principal balance of their mortgage loan. The latter approach, however, is not available to those whose loan-to-value ratio has already reached the maximum permitted by the lender. For those without the available cash, who are at the maximum loan-to-value ratio, or who simply choose to do so, there is a third option. This third option is a yield spread premium.

Yield spread premiums permit homebuyers to pay some or all of the up front settlement costs over the life of the mortgage through a higher interest rate. Because the mortgage

carries a higher interest rate, the lender is able to sell it to an investor at a higher price. In turn, the lender pays the broker an amount reflective of this price difference. The payment allows the broker to recoup the up front costs incurred on the borrower's behalf in originating the loan. Payments from lenders to brokers based on the rates of borrowers' loans are characterized as "indirect" fees and are referred to as yield spread premiums.[1]

A yield spread premium is calculated based upon the difference between the interest rate at which the broker originates the loan and the par, or market, rate offered by a lender. The Department believes, and industry and consumers agree, that a yield spread premium can be a useful means to pay some or all of a borrower's settlement costs. In these cases, lender payments reduce the up front cash requirements to borrowers. In some cases, borrowers are able to obtain loans without paying any up front cash for the services required in connection with the origination of the loan. Instead, the fees for these services are financed through a higher interest rate on the loan. The yield spread premium thus can be a legitimate tool to assist the borrower. The availability of this option fosters homeownership.

HUD has recognized the utility of yield spread premiums in regulations issued prior to the 1999 Statement of Policy. In a final rule concerning "Deregulation of Mortgagor Income Requirements," HUD indicated that up front costs

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[1] Indirect fees from lenders are also known as "back funded payments," "overages," or "servicing release premiums."

could be lowered by yield spread premiums.54 FR 38646 (September 20, 1989).

In a 1992 rule concerning RESPA, HUD specifically listed yield spread premiums as an example of fees that must be disclosed. The example was codified as Illustrations of Requirements of RESPA, Fact Situations 5 and 13 in Appendix B to 24 CFR part 3500. (See also Instructions at Appendix A to 24 CFR part 3500 for Completing HUD-1 and HUD-1A Settlement Statements.) HUD did not by these examples mean that yield spread premiums were *per se* legal, but HUD also did not mean that yield spread premiums were *per se* illegal.

HUD also recognizes, however, that in some cases less scrupulous brokers and lenders take advantage of the complexity of the settlement transaction and use yield spread premiums as a way to enhance the profitability of mortgage transactions without offering the borrower lower up front fees. In these cases, yield spread premiums serve to increase the borrower's interest rate and the broker's overall compensation, without lowering up front cash requirements for the borrower. As set forth in this Statement of Policy, such uses of yield spread premiums may result in total compensation in excess of what is reasonably related to the total value of the origination services provided by the broker, and fail to comply with the second part of HUD's two-part test as enunciated in the 1999 Statement of Policy, and with Section 8.

The 1999 Statement of Policy's Test for Legality

The Department restates its position that yield spread premiums are not per se illegal. HUD also reiterates that this statement "does not imply * * * that yield spread premiums are legal in individual cases or classes of transactions." 64 FR 10084. The legality of any yield spread premium can only be evaluated in the context of the test HUD established and the specific factual circumstances applicable to each transaction in which a yield spread premium is used.

The 1999 Statement of Policy established a two-part test for determining whether lender payments to mortgage brokers are legal under RESPA. In applying Section 8 and HUD's regulations, the 1999 Statement of Policy stated:

In transactions where lenders make payments to mortgage brokers, HUD does not consider such payments (*i.e.*, yield spread premiums or any other class of named payments) to be illegal *per se*. HUD does not view the name of the payment as the appropriate issue under RESPA. HUD's position that lender payments to mortgage brokers are not illegal *per se* does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The fees in cases and classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA.

In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually furnished or that services have been actually

performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether it is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. HUD believes that total compensation should be carefully considered in relation to price structures and practices in similar transactions and in similar markets. 64 FR 10084.

Culpepper

The need for further clarification of HUD's position, as set forth in the 1999 Statement of Policy, on the treatment of lender payments to mortgage brokers under Section 8 of RESPA (12 U.S.C. 2607), is evident from the recent decision of the Court of Appeals for the Eleventh Circuit in *Culpepper*.

In upholding class certification in *Culpepper*, the court only applied the first part of the HUD test, and then further

narrowed its examination of whether the lender's yield spread payments were "for services" by focusing exclusively on the presumed intent of the lender in making the payments. The crux of the court's decision is that Section 8 liability for the payment of unlawful referral fees could be established under the first part of the HUD test alone, based on the facts that the lender's payments to mortgage brokers were calculated solely on the difference between the par interest rate and the higher rate at which the mortgage brokers delivered loans, and that the lender had no knowledge of what services, if any, the brokers had performed.

HUD was not a party to the case and disagrees with the judicial interpretation regarding Section 8 of RESPA and the 1999 Statement of Policy.

Clarification of the HUD Test

It is HUD's position that where compensable services are performed, the 1999 Statement of Policy requires application of both parts of the HUD test before a determination can be made regarding the legality of a lender payment to a mortgage broker.

1. The First Part of the HUD Test: Under the first part of HUD's test, the total compensation to a mortgage broker, of which a yield spread premium may be a component or the entire amount, must be for goods or facilities provided or services performed. HUD's position is that in order to discern whether a yield spread premium was for goods, facilities or services under the first part of the HUD test, it is necessary to look at each transaction individually, including examining all of the goods or facilities provided or services performed

by the broker in the transaction, whether the goods, facilities or services are paid for by the borrower, the lender, or partly by both.

It is HUD's position that neither Section 8(a) of RESPA nor the 1999 Statement of Policy supports the conclusion that a yield spread premium can be presumed to be a referral fee based solely upon the fact that the lender pays the broker a yield spread premium that is based upon a rate sheet, or because the lender does not have specific knowledge of what services the broker has performed. HUD considers the latter situation to be rare. The common industry practice is that lenders follow underwriting standards that demand a review of originations and that therefore lenders typically know that brokers have performed the services required to meet those standards.

Yield spread premiums are by definition derived from the interest rate. HUD believes that a rate sheet is merely a mechanism for displaying the yield spread premium, and does not indicate whether a particular yield spread premium is a payment for goods and facilities actually furnished or services actually performed under the HUD test. Whether or not a yield spread premium is legal or illegal cannot be determined by the use of a rate sheet, but by how HUD's test applies to the transaction involved.

Section 8 prohibits the giving and accepting of fees, kickbacks, or things of value for the referral of settlement services and also unearned fees. It is therefore prudent for a lender to take action so as to ensure that brokers are performing compensable services and receiving only compensation that, in total, is reasonable for those services

provided. As stated, however, in the 1999 Statement of Policy:

> The Department recognizes that some of the goods or facilities actually furnished or services actually performed by the broker in originating a loan are "for" the lender and other goods or facilities actually furnished or services actually performed are "for" the borrower. HUD does not believe that it is necessary or even feasible to identify or allocate which facilities, goods or services are performed or provided for the lender, for the borrower, or as a function of State or Federal law. All services, goods and facilities inure to the benefit of both the borrower and the lender in the sense that they make the loan transaction possible. * * * 64 FR 10086.

The 1999 Statement of Policy provided a list of compensable loan origination services originally developed by HUD in a response to an inquiry from the Independent Bankers Association of America (IBAA), which HUD considers relevant in evaluating mortgage broker services. In analyzing each transaction to determine if services are performed HUD believes the 1999 Statement of Policy should be used as a guide. As stated there, the IBAA list is not exhaustive, and while technology is changing the process of performing settlement services, HUD believes that the list is still a generally accurate description of settlement services. Compensation for these services may be paid either by the borrower or by the lender, or partly by both. Compensable services for the first part of the test do not include referrals or no, nominal, or duplicative work.

2. Reasonableness of Broker Fees: The second part of HUD's test requires that total compensation to the mortgage

broker be reasonably related to the total set of goods or facilities actually furnished or services performed.

The 1999 Statement of Policy said in part:

The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. 64 FR 10084.

Accordingly, the Department believes that the second part of the test is applied by determining whether a mortgage broker's total compensation is reasonable. Total compensation includes fees paid by a borrower and any yield spread premium paid by a lender, not simply the yield spread premium alone. Yield spread premiums serve to allow the borrower a lower up front cash payment in return for a higher interest rate, while allowing the broker to recoup the total costs of originating the loan. Total compensation to the broker must be reasonably related to the total value of goods or facilities provided or services performed by the broker. Simply delivering a loan with a higher interest rate is not a compensable service. The Department affirms the 1999 Statement of Policy's position on this matter for purposes of RESPA enforcement.

The 1999 Statement also said:

In analyzing whether a particular payment or fee bears a reasonable relationship to the value of the goods or facilities actually furnished or services actually performed, HUD

believes that payments must be commensurate with the amount normally charged for similar services, goods or facilities. This analysis requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets. If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities or services provided, the excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section 8(a) or (b) of RESPA. 64 FR 10086.

The 1999 Statement of Policy also stated:

The level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants for particular loan programs. For example, applicants have differences in credit ratings, employment status, levels of debt, or experience that will translate into various degrees of effort required for processing a loan. Also, the mortgage broker may be required to perform various levels of services under different servicing or processing arrangements with wholesale lenders. 64 FR 10081.

In evaluating mortgage broker fees for enforcement purposes, HUD will consider these factors as relevant in assessing the reasonableness of mortgage broker compensation, as well as comparing total compensation for loans of similar size and similar characteristics within similar geographic markets.

Also, while the Department continues to believe that comparison to prices in similar markets is generally a key

factor in determining whether a mortgage broker's total compensation is reasonable, it is also true that in less competitive markets comparisons to the prices charged by other similarly situated providers may not, standing alone, provide a useful measure. As a general principle, HUD believes that in evaluating the reasonableness of broker compensation in less competitive markets, consideration of price structures from a wider range of providers may be warranted to reach a meaningful conclusion.

Part B. Providing Meaningful Information to Borrowers

In addition to addressing the legality of yield spread premiums in the 1999 Statement of Policy, HUD emphasized the importance of disclosing broker fees, including yield spread premiums.

There is no requirement under existing law that consumers be fully informed of the broker's services and compensation prior to the GFE. Nevertheless, HUD believes that the broker should provide the consumer with information about the broker's services and compensation, and agreement by the consumer to the arrangement should occur as early as possible in the process. 64 FR 10087.

HUD continues to believe that disclosure is extremely important, and that many of the concerns expressed by borrowers over yield spread premiums can be addressed by disclosing yield spread premiums, borrower compensation to the broker, and the terms of the mortgage loan, so that the borrower may evaluate and choose among alternative loan options.

In the 1999 Statement of Policy, HUD stated:

* * * HUD believes that for the market to work effectively, borrowers should be afforded a meaningful opportunity to select the most appropriate product and determine what price they are willing to pay for the loan based on disclosures which provide clear and understandable information.

The Department reiterates its long-standing view that disclosure alone does not make illegal fees legal under RESPA. On the other hand, while under current law, pre-application disclosure to the consumer is not required, HUD believes that fuller information provided at the earliest possible moment in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding. 64 FR 10087.

HUD currently requires the disclosure of yield spread premiums on the Good Faith Estimate and the HUD-1. The 1999 Statement of Policy said:

The Department has always indicated that any fees charged in settlement transactions should be clearly disclosed so that the consumer can understand the nature and recipient of the payment. Code-like abbreviations like YSP to DBG, POC', for instance, have been noted. [Footnote omitted.] Also the Department has seen examples on the GFE and/or the settlement statement where the identity and/or purposes of the fees are not clearly disclosed.

The Department considers unclear and confusing disclosures to be contrary to the statute's and the regulation's

purposes of making RESPA-covered transactions understandable to the consumer. At a minimum, all fees to the mortgage broker are to be clearly labeled and properly estimated on the GFE. On the settlement statement, the name of the recipient of the fee (in this case, the mortgage broker) is to be clearly labeled and listed, and the fee received from a lender is to be clearly labeled and listed in the interest of clarity. 64 FR 10086-10087.

While the disclosure on the GFE and HUD-1 is required, the Department is aware and has stated that the current GFE/HUD-1 disclosure framework is often insufficient to adequately inform consumers about yield spread premiums and other lender paid fees to brokers. Under the current rules, the GFE need not be provided until after the consumer has applied for a mortgage and may have paid a significant fee, and the HUD-1 is only given at closing. Because of this, HUD has in recent years sought to foster a more consumer beneficial approach to disclosure regarding yield spread premiums through successive rulemaking efforts. This history is discussed more fully in the 1999 Statement of Policy.[2]

Representatives of the mortgage industry have said that since the 1999 Statement of Policy, many brokers provide borrowers a disclosure describing the function of mortgage brokers and stating that a mortgage broker may receive a fee

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[2] In both the HUD/Federal Reserve Board Report on RESPA/TILA Reform, 1998, and the HUD/Treasury Report on Curbing Predatory Home Mortgage Lending, 2000, the agencies recommended earlier disclosures to facilitate shopping and lower settlement costs.

in the transaction from the lender. While the 1999 Statement of Policy commended the National Association of Mortgage Brokers and the Mortgage Bankers Association of America for strongly suggesting such a disclosure to their respective memberships, the Statement of Policy added:

> Although this statement of policy does not mandate disclosures beyond those currently required by RESPA and Regulation X, the most effective approach to disclosure would allow a prospective borrower to properly evaluate the nature of the services and all costs for a broker transaction, and to agree to such services and costs before applying for a loan. Under such an approach, the broker would make the borrower aware of whether the broker is or is not serving as the consumer's agent to shop for a loan, and the total compensation to be paid to the mortgage broker, including the amounts of each of the fees making up the compensation. 64 FR 10087.

In HUD's view, meaningful disclosure includes many types of information: what services a mortgage broker will perform, the amount of the broker's total compensation for performing those services (including any yield spread premium paid by the lender), and whether or not the broker has an agency or fiduciary relationship with the borrower. The disclosure should also make the borrower aware that he or she may pay higher up front costs for a mortgage with a lower interest rate, or conversely pay a higher interest rate in return for lower up front costs, and should identify the specific trade-off between the amount of the increase in the borrower's monthly payment (and also the increase in the interest rate) and the amount by which up front costs are reduced. HUD believes that disclosure of this information,

and written acknowledgment by the borrower that he or she has received the information, should be provided early in the transaction. Such disclosure facilitates comparison shopping by the borrower, to choose the best combination of up front costs and mortgage terms from his or her individual standpoint. HUD regards full disclosure and written acknowledgment by the borrower, at the earliest possible time, as a best practice.

Yield spread premiums are currently required to be listed in the "800" series of the HUD-1 form, listing "Items Payable in Connection with Loan." This existing practice, however, does not disclose the purpose of the yield spread premium, which is to lower up front cost to borrowers. To achieve this end it has been suggested to the Department that the yield spread premium should be reported as a credit to the borrower in the "200" series, among the "Amounts Paid by or in Behalf of Borrowers." The homebuyer or homeowner could then see that the yield spread premium is reducing closing costs, and also see the extent of the reduction.

HUD believes that improved early disclosure regarding mortgage broker compensation and the entry of yield spread premiums as credits to borrowers on the GFE and the HUD-1 settlement statement are both useful and complementary forms of disclosure. The Department believes that used together these methods of disclosure offer greater assurance that lender payments to mortgage brokers serve borrowers' best interests.

While the 1999 Policy Statement and IV. Part A. of this Statement only cover certain lender payments to mortgage brokers, as described above, HUD also believes that similar

information on the trade-off between lower up front costs and higher interest rates and monthly payments should be disclosed to borrowers on all mortgage loan originations, not merely those originated by brokers. HUD is aware that while yield spread premiums are not used in loans originated by lenders, lenders are able to offer loans with low or no up front costs required at closing by charging higher interest rates and recouping the costs by selling the loans into the secondary market for a price representing the difference between the interest rate on the loan and the par, or market, interest rate. Sale of such a loan achieves the same purpose as the yield spread premium does on a loan originated by a broker. The Department strongly believes that all lenders and brokers should provide the level of consumer disclosure that the purposes of RESPA intend and that fair business practices demand. As indicated in the 1999 Statement of Policy, HUD emphasizes that fuller information provided as early as possible in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding. In the future, full and early disclosures are factors that the Department would weigh favorably in exercising its enforcement discretion in cases involving mortgage broker fees. Nevertheless, the Department also again makes clear that disclosure alone does not make illegal fees legal under RESPA. The Department will scrutinize all relevant information in making enforcement decisions, including whether transactions evidence practices that may be illegal.

Part C. Section 8(b) Unearned Fees

A. Background

RESPA was enacted in 1974 to provide consumers "greater and more timely information on the nature of the costs of the [real estate] settlement process" and to protect consumers from "unnecessarily high settlement charges caused by certain abusive practices * * *" 12 U.S.C. 2601.

Since RESPA was enacted, HUD has interpreted Section 8(b) as prohibiting any person from giving or accepting any unearned fees, i.e., charges or payments for real estate settlement services other than for goods or facilities provided or services performed. Payments that are unearned fees for settlement services occur in, but are not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider marks-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one settlement service provider charges the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

In the first situation, two settlement service providers split or share a fee charged to a consumer and at least part, if not all, of at least one provider's share of the fee is unearned. In the second situation, a settlement service provider charges a fee to a consumer for another provider's services that is

higher than the actual price of such services, and keeps the difference without performing any actual, necessary, and distinct services to justify the additional charge. In the third situation, one settlement service provider charges a fee to a consumer where no work is done or the fee exceeds the reasonable value of the services performed by that provider, and for this reason the fee or any portion thereof for which services are not performed is unearned.

HUD regards all of these situations as legally indistinguishable, in that they involve payments for settlement services where all or a portion of the fees are unearned and, thus, are violative of the statute. HUD, therefore, specifically interprets Section 8(b) as not being limited to situations where at least two persons split or share an unearned fee for the provision to be violated.

As already indicated in this Statement of Policy, meaningful disclosure of all charges and fees is essential under RESPA. Such disclosures help protect consumers from paying unearned or duplicate fees. However, as noted above, in the 1999 Statement of Policy the Department reiterated "its long-standing view that disclosure alone does not make illegal fees legal under RESPA." 64 FR 10087.

B. HUD's Guidance and Regulations

HUD guidance and regulations have consistently interpreted Section 8 as prohibiting all unearned fees. In 1976, HUD issued a Settlement Costs Booklet that provided that "[i] t is also illegal to charge or accept a fee or part of a fee where no service has actually been performed." 41 FR 20289 (May 17, 1976). Between 1976 and 1992, HUD

indicated in informal opinions that unearned fees occur where there are excessive fees charged, regardless of the number of settlement service providers involved.[3]

In the preamble to HUD's 1992 final rule revising Regulation X *(57 FR 49600* (November 2, 1992)), HUD stated: "Section 8 of RESPA (12 U.S.C. 2607) prohibits kickbacks for referral of business incident to or part of a settlement service and also prohibits the splitting of a charge for a settlement service, other than for services actually performed (i.e., no payment of unearned fees)." 57 FR 49600 (November 2, 1992).

HUD's regulations, published on November 2, 1992, implement Section 8(b). Section 3500.14(c)[4] provides:

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[3] *See* e.g., Old Informal Opinion (6), August 16, 1976 and Old Informal Opinion (65), April 4, 1980; Barron and Berenson, *Federal Regulation of Real Estate and Mortgage Lending,* (4th Ed.1998). On November 2, 1992 *(57 F.R. 49600),* when HUD issued revisions to its RESPA regulations, it withdrew all of its informal counsel opinions and staff interpretations issued before that date. The 1992 rule provided, however, that courts and administrative agencies could use HUD's previous opinions to determine the validity of conduct occurring under the previous version of Regulation X. *See* 24 CFR 3500.4(c).

[4] The heading to 24 CFR 3500.14 is titled "Prohibition against kickbacks and unearned fees." However, the heading of subsection (c) is titled "split of charges," and the preamble to the November 1992 rule states "[s]ection 8 of RESPA (12 U.S.C. 2607) prohibits kickbacks for referral of business incident to or part of a settlement service and also prohibits the splitting of a charge for a settlement service, other than for services actually performed

No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a settlement service in connection with a transaction involving a federally-related mortgage loan other than for services actually performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this Section. The source of the payment does not determine whether or not a service is compensable. Nor may the prohibitions of this part be avoided by creating an arrangement wherein the purchaser of services splits the fee.

24 CFR 3500.14(g)(2) states in part:

The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. These facts may be used as evidence of a violation of Section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation.

(i.e., no payment of unearned fees)." 57 FR 49600 (November 2, 1992). The rule headings and preamble text are a generalized description of Section 8 that is more developed in the actual regulation text. As discussed in Section D of this Statement of Policy, HUD believes that the actual text of the rules, as amended in 1992, makes clear that Section 8(b)'s prohibitions against unearned fees apply even when only one settlement service provider is involved.

24 CFR 3500.14(g)(3) provides in part:

When a person in a position to refer settlement service business * * * receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person.

In Appendix B to the HUD RESPA regulations, HUD provides illustrations of the requirements of RESPA. Comment 3 states in part:

The payment of a commission or portion of the * * * premium * * * or receipt of a portion of the payment * * * where no substantial services are being performed * * * is a violation of Section 8 of RESPA. It makes no difference whether the payment comes from [the settlement service provider] or the purchaser. The amount of the payment must bear a reasonable relationship to the services rendered. Here [the real estate broker in the example] is being compensated for a referral of business to [the title company].

In 1996, in the preamble to the final rule on the Withdrawal of Employer/Employee and Computer Loan Origination Systems Exemptions[5] (61 FR 29238 (June 7, 1996)), HUD reiterated its interpretation of Section 8(b) of RESPA as follows:

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[5] This final rule was delayed by legislation, but the Department implemented portions of the final rule that were not affected by the legislative delay on November 15, 1996. 61 FR 58472 (November 15, 1996).

HUD believes that Section 8(b) of the statute and the legislative history make clear that no person is allowed to receive any portion' of charges for settlement services, except for services actually performed. The provisions of Section 8(b) could apply in a number of situations: (1) where one settlement service provider receives an unearned fee from another provider; (2) where one settlement service provider charges the consumer for third-party services and retains an unearned fee from the payment received; or (3) where one settlement service provider accepts a portion of a charge (including 100% of the charge) for other than services actually performed. The interpretation urged [by the commenters to the proposed rule published on July 21, 1994], that a single settlement service provider can charge unearned or excessive fees so long as the fees are not shared with another, is an unnecessarily restrictive interpretation of a statute designed to reduce unnecessary costs to consumers. The Secretary, charged by statute with interpreting RESPA, interprets Section 8(b) to mean that two persons are not required for the provision to be violated. 61 FR 29249.

The latest revision to the Settlement Costs Booklet for consumers, issued in 1997, also provides "[i]t is also illegal for anyone to accept a fee or part of a fee for services if that person has not actually performed settlement services for the fee." 62 FR 31998 (June 11, 1997).

Further, HUD has provided information to the public and the mortgage industry in the "Frequently Asked Questions" section of its RESPA Web site, located at *http://www. hud.gov/fha/sfh/res/resindus.html* >. Question 25 states:

Can a lender collect from the borrower an appraisal fee of $200, listing the fee as such on the HUD-1, yet pay an independent appraiser $175 and collect the $25 difference?

The answer reads:

No, the lender may only collect $175 as the actual charge. It is a violation of Section 8(b) for any person to accept a split of a fee where services are not performed.

In 1999, by letter submitted at the request of the Superior Court of California, Los Angeles County, in the case of *Brown* v. *Washington Mutual Bank* (Case No. BC192874), HUD provided the following response to a specific question posed by the court on lender "markups" of another settlement service provider's fees:

A lender that purchases third party vendor services for purposes of closing a federally related mortgage loan may not, under RESPA, mark up the third party vendor fees for purposes of making a profit. HUD has consistently advised that where lenders or others charge consumers marked-up prices for services performed by the third party providers without performing additional services, such charges constitute "splits of fees" or "unearned fees" in violation of Section 8(b) of RESPA.

HUD noted in its letter to the court that the response reflected the Department's long-standing position.

C. Recent Cases

Notwithstanding HUD's regulations and other guidance, the Court of Appeals for the Seventh Circuit held, in *Echevarria v. Chicago Title and Trust Co.*, 256 F.3d 623 (7th Cir. 2001), that Section 8(b) was not violated where a title company, without performing any additional services, charged the plaintiffs more money than was required by the recorder's office to record a deed and the title company then retained the difference. The court reasoned that plaintiffs "failed to plead facts tending to show that Chicago Title illegally shared fees with the Cook County Recorder. The Cook County Recorder received no more than its regular recording fees and it did not give to or arrange for Chicago Title to receive an unearned portion of these fees. The County Recorder has not engaged in the third party involvement necessary to state a claim under [RESPA § 8(b)]." *Id.* at 626. The court in essence concluded that unearned fees must be passed from one settlement provider to another in order for such fees to violate Section 8(b).

Earlier, in *Willis v. Quality Mortgage USA, Inc.*, 5 F. Supp. 2d 1306 (M.D. Ala. 1998), cited by the Seventh Circuit in support of its conclusion, the district court concluded that 24 CFR 3500.14(c), "[w]hen read as a whole," prohibits payments for which no services are performed "only if those payments are split with another party." *Id.* at 1309. The *Willis* court held that there must be a split of a charge between a settlement service provider and a third party to establish a violation Section 8(b). The court also concluded that 24 CFR 3500.14(g)(3) only applied when there was a payment from a lender to a broker, or vice versa. The payment from a

borrower to a mortgage lender could not be the basis for a violation of 24 CFR 3500.14(g)(3) and Section 8(b).

HUD was not a party to the cases and disagrees with these judicial interpretations of Section 8(b) which it regards as inconsistent with HUD's regulations and HUD's long-standing interpretations of Section 8(b).

D. Unearned Fees Under Section 8(b)

This Statement of Policy reaffirms HUD's existing, long-standing interpretation of Section 8(b) of RESPA. Sections 8(a) and (b) of RESPA contain distinct prohibitions. Section 8(a) prohibits the giving or acceptance of any payment pursuant to an agreement or understanding for the referral of settlement service business involving a federally related mortgage loan; it is intended to eliminate kickbacks or compensated referral arrangements among settlement service providers. Section 8(b) prohibits the giving or accepting of any portion, split, or percentage of any charge other than for goods or facilities provided or services performed; it is intended to eliminate unearned fees. Such fees are contrary to the Congressional finding when enacting RESPA that consumers need protection from unnecessarily high settlement charges. 12 U.S.C. 2601(a).

It is HUD's position that Section 8(b) proscribes the acceptance of any portion or part of a charge other than for services actually performed. Inasmuch as Section 8(b)'s proscription against "any portion, split, or percentage" of an unearned charge for settlement services is written in the disjunctive, the prohibition is not limited to a split. In HUD's view, Section 8(b) forbids the paying or accepting of any

portion or percentage of a settlement service-including up to 100%-that is unearned, whether the entire charge is divided or split among more than one person or entity or is retained by a single person. Simply put, given that Section 8(b) proscribes unearned portions or percentages as well as splits, HUD does not regard the provision as restricting only fee splitting among settlement service providers. Further, since Section 8(b) on its face prohibits the giving or accepting of an unearned fee by any person, and 24 CFR 3500.14(c) speaks of a charge by "a person," it is also incorrect to conclude that the Section 8(b) proscription covers only payments or charges among settlement service providers.[6]

A settlement service provider may not levy an additional charge upon a borrower for another settlement service provider's services without providing additional services that are bona fide and justify the increased charge. Accordingly, a settlement service provider may not mark-up the cost of another provider's services without providing additional settlement services; such payment must be for services that are actual, necessary and distinct services provided to justify the charge. 24 CFR 3500.14(g)(3).[7] The

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[6] HUD is, of course, unlikely to direct any enforcement actions against consumers for the payment of unearned fees, because a consumer's intent is to make payment for services, not an unearned fee.

[7] HUD notes that some lenders have charged an additional fee merely for "reviewing" another settlement service provider's services. HUD does not regard such "review" as constituting an actual, necessary, or distinct additional service permissible under HUD's regulations.

HUD regulation implementing Section 8(b) states: "[a] charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this Section." 24 CFR 3500.14 (c).

The regulations also make clear that a charge by a single service provider where little or no services are performed is an unearned fee that is prohibited by the statute. 24 CFR 3000.14(c). A single service provider is also prohibited from charging a duplicative fee. Further, a single service provider cannot serve in two capacities, e.g., a title agent and closing attorney, and be paid twice for the same service. The fee the service provider would be receiving in this case is duplicative under 24 CFR 3000.14(c) and not necessary and distinct under 24 CFR 3000.14(g)(3). Clearly, in all of these instances, the source of the payment-whether from consumers, other settlement service providers, or other third parties-is not relevant in determining whether the fee is earned or unearned because ultimately, all settlement payments come directly or indirectly from the consumer. See 24 CFR 3500.14(c). Therefore, a single settlement service provider violates Section 8(b) whenever it receives an unearned fee.

A single service provider also may be liable under Section 8(b) when it charges a fee that exceeds the reasonable value of goods, facilities, or services provided. HUD's regulations as noted state: "If the payment of a thing of value bears no relationship to the goods or services provided, then the excess is not for services or goods actually performed or provided." 24 CFR 3500.14(g)(2). Section 8(c)(2) only allows "the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually

furnished or services actually performed," i.e., permitting only that compensation which is reasonably related to the goods or facilities provided or services performed. Compensation that is unreasonable is unearned under Section 8(b) and is not bona fide under Section 8(c)(2).

The Secretary, therefore, interprets Section 8(b) of RESPA to prohibit all unearned fees, including, but not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider marks-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one service provider charges the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

V. Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) has reviewed this Statement of Policy in accordance with Executive Order 12866, (captioned "Regulatory Planning and Review"). OMB determined that this Statement of Policy is a "significant regulatory action" as defined in Section 3(f) of the Order (although not an economically significant regulatory action under the Order). Any changes to the Statement of Policy resulting from this review are available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk.

Dated: October 15, 2001.

John C. Weicher,
Assistant Secretary for Housing-Federal Housing Commissioner.